Program Summary
Attorney General – Department of Law
Master Settlement Agreement

Program Overview

In the 1990's, Tobacco manufacturers were being sued for damages related to cigarette smoking. As a result, the four largest cigarette manufacturers, known as the Original Participating Manufacturers (OPMs), entered into a Master Settlement Agreement (MSA) in November 1998 with 46 states, including Arizona, the District of Columbia and six territories to pay damages for the cost of treating smoking-related illnesses. According to the MSA, state lawsuits against manufacturers would be dismissed in exchange for annual settlement payments to be received on April 15th of each year until 2025, as well as restrictions on cigarette marketing and advertising practices. Since 1998, additional cigarette manufacturers, known as Subsequent Participating Manufacturers (SPMs), have signed into the MSA. Cigarette manufacturers that have not signed the MSA are known as Non-Participating Manufacturers (NPM).

In FY 2002, the Tobacco Enforcement Unit was created in the Attorney General's (AG) office. The sole purpose of the Tobacco Enforcement Unit is to enforce the provisions of the Master Settlement Agreement and ensure that the state receives its annual payments.

As of FY 2006, the annual payments received by the state are deposited into the Tobacco Litigation Settlement Fund, which provides funding to expand the AHCCCS program to 100% of the Federal Poverty Level and for 6 public health programs as required by Proposition 204 in the 2000 General Election. Prior to FY 2006, a portion of the annual payment had been appropriated to the Department of Health Services (DHS) for DHS-related Proposition 204 expenditures. Because the annual payments are not received until April of each year, DHS had difficulty in identifying state match monies to draw down federal dollars, and therefore their portion of the annual payment was appropriated to AHCCCS and replaced with General Fund dollars in the DHS budget.

Program Funding

In FY 2002, the Attorney General's office received $300,000 from the General Fund for the creation of the Tobacco Enforcement Unit. The Unit has 4 FTE Positions. Since FY 2002, funding has been added to the Unit only for standard statewide adjustments.

Annual Payments to the State

The state's annual payment is based on a formula contained in the settlement agreement, which is subject to three adjustments annually:

1) An inflation adjustment that accounts for the change in the value of a dollar from year to year;
2) A volume adjustment that ensures payments to the states is based on the total number of cigarettes sold by participating manufacturers;
3) A NPM adjustment for gain of market share by Non-Participating Manufacturers.

The intent of the NPM adjustment is to correct for the possible creation of an unfair market as a result of the MSA. At the time the MSA was negotiated, the OPMs raised concerns that the annual payment to the states would require them to raise prices in order to remain profitable, while the NPMs would not be faced with the same requirement and could therefore avoid a similar adjustment in prices. As a result, the MSA contains provisions, known as model statutes, that all 46 states and six territories have adopted in an attempt to level the playing field. These statutes require NPMs to make deposits into an escrow account proportional to the number of cigarettes sold in that state each year. This money is not available for state use and can only be obtained in the event that the state files suit against the manufacturer and prevails. If the state does not file suit successfully before 2026, the money in the escrow account is returned to the manufacturer.

Any state that has not enacted or properly enforced the model statutes for a given year has its payment decreased according to a NPM adjustment. Both OPMs and SPMs can make the NPM adjustment to their annual payment. The NPM adjustment is calculated by multiplying the market share loss for the OPMs from the previous year in a given state by 3. In other words, a 2% loss of market share by OPMs would result in a 6% reduction in the allocated payment to the respective state.

Table 1 lists the annual payments received by the state in FY 1999 through FY 2006. Since FY 1999, the state has received a total of $699.7 million.

In April 2006, the state was entitled to an annual payment of $97 million, but only received $86.3 million due to the ruling of an independent arbiter in March 2006 that the MSA contributed to a loss in market share for the OPMs in sales year 2003. In order to receive the amount still owed to the state, which is $10.7 million, the AG's office would have to sue the tobacco manufacturers that chose to make the NPM withholding and prove that they have diligently enforced the model statutes. This proceeding could take anywhere from 1 to 2 years and the AG cannot predict if the state will be successful, and if the $10.7 million would be settled for a reduced amount. The AG's office has not filed suit to date against the tobacco manufacturers that chose to make the withholding. The AG predicts that the tobacco manufacturers will attempt to make a similar withholding on an annual basis.

Table 1

MSA Annual Payments
FY 1999 - FY 2006

Fiscal Year	MSA Payment
FY 1999 - FY 2001	$207,966,000
FY 2002	111,955,069
FY 2003	106,926,757
FY 2004	92,648,165
FY 2005	93,933,400
FY 2006*	86,301,152
Total	**$699,730,543**

* The state's annual payment was $96,941,400, but $86.3 million was received due to the NPM withholding